Natural Gas Rides High, for Now; Prices May Ease As New Supplies Reach the Market

Wall Street Journal (March 17)
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Natural-gas prices are near two-year highs and outpacing price increases for oil, driving up costs for companies and consumers.

But many market watchers predict a fall in coming months, as new supplies come to market following years of flat production.

The price of gas hit $9.868 per million British thermal units Friday after topping $10 earlier last week, as investors spooked by the stock markets and worries about the U.S. economy poured money into commodities like oil and gold. Gas is up 32% since the start of the year, putting it near its highest level since hurricanes Katrina and Rita hit the gas-rich Gulf of Mexico nearly three years ago.

Gas meets about a fifth of the nation's electricity needs, heats about half of its homes and is an important ingredient for making plastics and fertilizer. The fuel is increasingly in demand because it burns more cleanly than coal.

Analysts cite a variety of factors for gas's run-up in addition to the general rise in commodities. They include a colder-than-expected winter; falling production in Canada; and rising demand for oil, which has been propelled by investors seeking a safe haven.

"I don't think we would have hit $10 [per million BTUs] if crude oil wasn't up at $100 [a barrel]," says Guy Gleichmann, president of United Strategic Investors Group in Hollywood, Fla., which doesn't have an investment in gas.

The rise comes at a time when oil-and-gas companies, citing long-term trends, are redoubling efforts to find new gas supplies. Driving the trend: concerns over pollution and climate change. The U.S. Natural Gas Council, an industry group, predicts a carbon-capping system such as one now being considered by Congress could lead to a 20% increase in natural gas consumption over the next decade.

"We clearly see that people are rejecting coal plants in every state we can think of, so we've got to come up with alternatives that work for the American consumer," says James Hackett, chairman and chief executive of Anadarko Petroleum Corp., one of the nation's largest producers of natural gas. "The power market will increasingly turn to natural gas as its one alternative."

Those efforts are adding new gas supplies to the market after a decade of flat or falling production. Production last year rose 4.3% according to one government measure, marking the largest rise in more than 20 years. Most expect production to continue to rise this year.

Over the short term, that could lead to new supplies that drive down prices later this year. Summer pricing predictions vary widely, but most analysts say natural-gas storage figures released last week would support summer prices around $7 to $8 per million BTUs.

"At some point these high production rates are going to push prices down," Credit Suisse analyst Jonathan Wolff says.

J. Marshall Adkins, an analyst with Raymond James in Houston, predicts prices could drop to $5 per million BTUs or lower over the summer, especially if warm weather reduces demand in coming weeks.

Many wells being drilled today require gas prices above $7 per million BTUs to be viable, and exploration in emerging areas such as the Marcellus shale in Pennsylvania could be even more expensive.

Some market watchers expect prices to remain high in coming months. Natural gas producers may have trouble keeping up last year's growth rate, they say. Offshore production in the Gulf of Mexico shot up 7% in December from the previous year, but that growth was almost entirely due to Independence Hub, a massive new offshore drilling project that went online late last year. With no similar projects anticipated in the immediate future, most analysts expect offshore growth to level off this year or next.

Meanwhile, onshore production growth has relied heavily on the increased production in Texas and Wyoming, which together accounted for 78% of onshore growth last year.